TAXES

Tax-Savvy Investment Strategies

With a little planning, you can help limit your tax exposure.

by Teri Cettina | Posted: April 06, 2015

If you just finished writing a hefty check to the IRS because you got a big raise in 2014 or earned significant capital gains on your investments, you probably don't even want to think about taxes again until next spring. However, the reality is that there's probably no better time than now to start planning to help you reduce your tax liability for 2015.

Of course, there's no one magic bullet for reducing liability. And tax savings should never be the only factor behind any investment decision, says Kris Gretzschel, CFP®, Manager of the Tax & Financial Planning Group for Wells Fargo Advisors. However, by thinking proactively about taxes and monitoring your use of tax-advantaged investments, you may be able to keep more of your money working for you.

Plan a summer tax meeting
By May, many tax professionals and Financial Advisors have wrapped up the current tax season. But that doesn't mean you should avoid a conversation with your advisors so you can focus on your summer vacation plans. It's a great time to lay out your plans for the current year. "With April filings completed, your financial professional may have more time to consider tax planning for the year ahead," notes Gretzschel. "Plus, by midyear, you may have a better idea of the income or other financial changes you may be facing in 2015."

Start with tax-friendly accounts
According to Gretzschel, even many high-net-worth (and often highly taxed) individuals don't take full advantage of the tax-advantaged accounts available to them. Why not? Primarily because eligibility and withdrawal rules can seem incredibly complex. "Never let that discourage you," she cautions. "Your Financial Advisor can make sure you're clear on how these accounts play their part in your overall investment strategy."

Common tax-advantaged accounts include 529 college savings plans, personal IRAs, Roth IRAs, and workplace 401(k) or 403(b) retirement plans. In addition, a growing number of employers now offer Roth 401(k)s, which combine the benefits of a traditional retirement plan and a Roth IRA, and cash-balance retirement plans (https://lifescapes.wfmagazines.com/plan_invest/retirement/article/cash_balance_retirement_plans/), which are hybrids of a traditional pension and a 401(k). "These accounts can be really advantageous; however, there are always important caveats to consider," says Gretzschel. "If your company offers one, talk with your Financial Advisor about how it might work for you."

Balance your tax obligations
No one can be sure what U.S. tax rates will be in the future — or what tax bracket you might fall into when you retire. This is an important reason to hold a wide range of investments — some that are taxable when you withdraw them in retirement and some that are completely tax-free in the future.

"This is a good reason not to put all of your investable assets in your workplace retirement plan or a personal IRA, for instance," says Gretzschel. "You could end up creating a very high-tax income stream after you stop working, when you can least afford it." Work with your tax advisor to make sure your tax commitments are balanced.

Consider "location, location, location"
If you're investing in tax-advantaged accounts such as an IRA or work retirement plan to go along with after-tax investment accounts, you may want to include different types of holdings in each. For instance, you might include low-tax investments — such as municipal bonds or stocks that pay qualified dividends — in your after-tax accounts, suggests Gretzschel, and higher-tax investments — such as corporate or U.S. government bonds — in your tax-sheltered accounts. Your Financial Advisor can help you decide on the appropriate mix of investments for each type of account.

Straddle tax years when possible
There are times when it might make sense to liquidate some tax-incurring investments at the end of one tax year, and then wait and sell additional investments in the early part of the following tax year to spread out your tax exposure. Or if you anticipate a significant income change (up or down), you might want to either accelerate tax deductions into the current year or defer them to the following year to pay less in taxes. These kinds of strategies are best decided with the help of your or tax professional (along with input from your Financial Advisor) during a midyear meeting.

Don't overlook the Roth — for your kids and grandkids
If leaving a family legacy is important to you, one way to do so may be to contribute to a Roth account for your children and grandchildren, starting in their teen years. Even though you won't get a tax break for doing so, making contributions to this account is one way to harness some of the tax-free advantages of the Roth on your family's behalf, suggests Gretzschel.

To contribute to a Roth, your teen must have income from work. Contributions are limited to your child's or grandchild's actual compensation or the IRS maximum, whichever is less, says Gretzschel.

The bottom line: Don't wait until the end of the year to plan for next year's taxes, because some of the best strategies may take a little time to consider or implement.

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ADDITIONAL RESOURCES

Tax planning isn't just to help you in the current year. Your retirement planning should take taxes into consideration (https://lifescapes.wfmagazines.com/plan_invest/taxes/article/taxes_in_retirement/), too.

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